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TAGS: PGOV PREL ECON EFIN LE
SUBJECT: LEBANON: CBL GOVERNOR SALAMEH PESSIMISTIC ON
ECONOMIC REFORM, CRITICAL OF GOVERNMENT

Classified By: Ambassador Jeffrey D. Feltman for reasons 1.4 (b) and (d
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SUMMARY

¶1. (C) Central Bank Governor Salameh says the GOL barely met its Emergency Post Conflict Assistance program targets, is not making satisfactory progress on reform, will have a hard time meeting further benchmarks, and could not meet the higher standards required for a formal IMF program. Salameh admitted that he does not enjoy working with the IMF, but sees no alternative to restrain GOL spending and its demands for the Central Bank to "subsidize" the GOL by obtaining dollars. Salameh expressed concern that the opposition could use a recent assessment that the currency is overvalued to create turmoil in the foreign exchange market.

¶2. (C) Salameh drew several conclusions from the August 5 Metn by-election: the Maronite Church is no longer strong or unified enough to play a role in electing the next President, and General Aoun can no longer claim a mandate to represent a majority of Christians, and thus will be a less valuable ally to Hizballah. Finally, Salameh speculated that slow army progress and high casualty rates in fighting at Nahr al-Bared could reflect negatively on both Army Commander Sleiman and the GOL because they unwisely allocated the army's budget on salaries and perks rather than equipment and training. End summary.

GOL BARELY MEETING
EPCA BENCHMARKS

¶3. (C) Central Bank of Lebanon (CBL) Governor Riad Salameh on August 6 told the Ambassador and Econoff that the GOL barely met its International Monetary Fund (IMF) Emergency Post Conflict Assistance (EPCA) program targets, and is not making satisfactory progress on reform. The GOL hit its ceiling for borrowing from the CBL, but is likely to exceed that ceiling in the second half of the year. To make this point to the GOL, Salameh has refused to sign a GOL letter to the IMF until the GOL shows him documentation proving that it has met EPCA benchmarks. In particular, Salameh insists on seeing a Ministry of Justice opinion that the Higher Council for Privatization (HCP) does not need to pass a new law to sell the assets of the state-owned mobile phone companies. The IMF agreed that this opinion would replace the benchmark requiring passage of a law through the (now closed) parliament.

¶4. (C) The GOL will have a harder time meeting stricter

second half targets. The CBL will find it difficult to keep GOL borrowing under its ceiling, and the MOF may not meet its pledge to reform institutions such as Electricite du Liban (EDL). The political patronage system prevents the GOL from reforming or eliminating EDL and allowing private producers to sell onto the national grid, Salameh assessed. He accused March 14 leaders of favoring their supporters by allowing as many illegal connections in pro-government areas as in the Hizballah stronghold of the southern suburbs. The GOL is also not exploiting opportunities to privatize telecom and water resources. Salameh implied that the GOL could not meet the higher standards required for a formal IMF program, and suggested an extension of the EPCA for a second year would be more realistic.

LEBANON NEEDS IMF
TO IMPOSE DISCIPLINE...

¶5. (C) Salameh admitted that he does not support or enjoy working with the IMF, but sees no alternative to restrain GOL spending. "If the government continues as is, it will collapse," Salameh argued. "There is a limit to Lebanon's financial engineering." Even if normal economic activity resumed tomorrow, Lebanon would need a disciplined budget, he reiterated, and the GOL is still increasing its debt by $2 billion a year.

¶6. (C) The GOL needs to downsize, Salameh argued, but to maximize the value of the assets to be sold the GOL should not privatize until all government institutions are functioning and the GOL can ensure a transparent sale. The CBL does not need a new law to sell the airline MEA, which it owns, but will wait until the political crisis ends to sell

the company's stock to a strategic investor and individual shareholders. Salameh does not support the government's decision to sell state-owned mobile company assets without passing a new law (which would be virtually impossible with the Parliament not meeting). He argues that quality buyers will refuse to buy the assets or licenses without an indisputable legal title. Moreover, Salameh condemned the Telecom Regulatory Authority's decision to auction off the mobile licenses, and argued that the GOL should instead sell its state-owned companies via a public offering.

...AND PROTECT THE CBL

¶7. (C) The CBL needs continued IMF involvement to restrain unreasonable demands for the Bank to subsidize the GOL, Salameh continued. The CBL's greatest vulnerability is recurrent demands for the Bank to draw down reserves to facilitate GOL overspending. Since January 2006, Salameh explained, the CBL has transferred $1.5 billion to the GOL by subscribing to t-bills, selling reserves, and giving the dollars to the MOF. This is in addition to the CBL's $1.4 billion Paris III pledge to reduce GOL debt with profits from gold revaluation.

¶8. (C) The GOL's inability to secure dollars could cause the CBL to spend $1.5 billion from its reserves between August and December 2007, Salameh told us. With $1 billion more in debt service and $470 million in fuel import bills due by the end of the year, the CBL will need to liquidate Eurobonds, exceed the debt ceiling, or purchase dollars if the GOL does not secure promised Paris III budget support or issue new Eurobonds. Salameh urged the Ambassador to bolster GOL stability by convincing donors to follow through on their pledges: Kuwait has yet to deliver $300 million it pledged in summer 2006; the UAE has not delivered $300 million pledged at Paris III; France has not delivered its $500 million; the World Bank has not yet transferred its $175 million; and the U.S. has not transferred its $250 million. (Note: Following the meeting, Econoff exchanged information

with CBL staff to facilitate the first $50 million tranche of the USG cash transfer, due to replace GOL payments owed to the World Bank in late August. End note.)

¶9. (C) This and other issues have led to a simmering resentment between CBL and GOL officials, Salameh explained. In addition to the GOL's erosion of its foreign exchange reserves, CBL officials resent being ordered on short notice to fill payment gaps. In February with less than a week's notice the GOL demanded that the CBL subscribe to $1 billion in Eurobonds, and several times this year threatened to cut electricity nationwide if the CBL did not immediately procure dollars to pay for fuel imports. Second, the CBL requested the MOF issue Eurobonds instead of t-bills in exchange for those dollars, as Eurobonds bolster gross foreign exchange reserves and can be sold for dollars. The MOF refused, arguing that it has no legal authorization from parliament to increase its foreign currency debt. Finally, Salameh expressed frustration that Prime Minister (and former finance minister) Siniora has refused for two years to issue a cabinet decision implementing a new bank merger law that would provide incentives for troubled banks to merge.

IMF CONSIDERS
LL OVERVALUED

¶10. (C) Salameh warned the Ambassador that there would be a delay in the IMF board discussion of Lebanon's Article IV Review due to a global IMF board decision -- targeting China -- to re-assess the relative value of all major currencies. This IMF study assesses that Lebanon's Lira (LL) is overvalued, despite recent IMF statements that it is satisfied with the stability of Lebanon's currency regime. Lebanon has asked the IMF to delay board discussion and Article IV Review publication until after the political crisis ends, for fear the opposition will use this information to create turmoil in the exchange markets. The IMF has been sympathetic to this request for a delay.

METN NATIVE: BOTH CANDIDATES,
MARONITE COMMUNITY LOST

¶11. (C) Turning to politics, Salameh, the product of several old Metn families, expressed surprise that for the first time

the Maronite vote did not decide the outcome of an election in that district. The Patriarch's leverage has declined, Salameh commented; the Maronite church is as divided as the rest of the Christians, and it is now clear that the Patriarch will play no role in selecting the next president. In contrast, the Armenian vote for the first time tipped the balance in an election. Aside from their two-year political alliance with Aoun, traditional Armenian loyalty to the president probably prompted them to vote with the opposition, according to Salameh, who noted that Lebanon's first president gave the Armenians citizenship and earned their allegiance to the office.

¶12. (C) Salameh viewed the election as a loss for both candidates, neither of whom earned popular support. Christians rejected Aoun's recent leadership style. Lebanon now has proof that Aoun does not represent a majority of Christians; he won thanks to the votes of 7,000 Armenians, 18,000 Michel Murr supporters, and 3,000 nationalized Syrians, while Aoun loyalists contributed a mere 11,000 votes. Salameh noted that the Metn elections changed prospects for the opposition. Now that it is clear that Aoun does not represent a Christian majority, Hizballah will likely start to distance itself from him, Salameh assessed.

¶13. (C) Amine Gemayel also lost, as many of the votes for him were really votes against Aoun or in sympathy for his assassinated son Pierre. An alternate candidate with less

historical baggage would likely have garnered more support, Salameh commented.

NAHR AL-BARED
REVEALS WEAKNESSES

¶14. (C) The ongoing conflict at Nahr al-Bared also changes conditions, Salameh commented, decreasing the likelihood that army commander Sleiman will be the next president. Sleiman would be a failure as president despite Syrian support, Salameh assessed, because without the army he will have no tool to help the country. Moreover, with over 200 soldiers killed or disabled, once the fighting concludes both Sleiman and the GOL will likely be criticized for overseeing an inefficient army with a bloated, poorly invested budget that did not prepare the institution to fight well. Salameh contrasted the army's inefficient, deadly 12-week battle against a small, confined threat to the efficient Israeli attack on Hizballah last summer. The GOL spent $15 billion on the army over the last 10 years, Salameh lamented, wasting over 90 percent of the army's annual budget on high salaries, early pensions, and privileges for officers' families. The public is sure to note that the army and the GOL favored officers' comfort over investment in modern equipment and training to face evolving threats.

MEA PROFITED
DESPITE THE WAR

¶15. (C) On a positive note, Salameh expressed pride that CBL-owned national carrier Middle East Airlines (MEA) earned $30 million in profits in 2006, despite the Israeli-Hizballah war. Salameh once again thanked the Ambassador for negotiating the safe departure of MEA's planes amidst Israeli bombing of the airport. Once outside Lebanon, MEA was able to rent out the planes for $15 million, helping to ensure the company's financial survival.
FELTMAN